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INTRODUCTION

The Office of Internal Audit performed an audit of the FIA State Make Whole accounting function associated with the Michigan State Disbursement Unit (FIA/MiSDU Accounting). The objectives of our audit were to evaluate the adequacy of the internal controls over the receipts, disbursements, and other accounting processes; and to determine if negotiable documents were properly safeguarded and accounted for; all receipts were recorded; all disbursements were authorized, included necessary supporting documentation, were properly recorded, and were proper in amount; and that all transactions were properly summarized, recorded and reported.

FIA/MiSDU Accounting performs various functions related to the processing of child support payments by ACS State and Local Solutions, Inc. (ACS) (the vendor that does the actual processing under contract with the FIA), including:

- Oversight and review of the ACS daily processing of employer child support receipts and the related accounting.

- Review of the bank reconciliations prepared by ACS.

- Maintenance of the official books and records of the MiSDU, including entries to MAIN.

- Accounting for and processing of transactions of the State Make Whole Account.

The State Make Whole Account was originally meant to provide funding for non-sufficient funds transactions. However, because ACS does not have check writing capabilities and it was determined that certain transactions could more efficiently be processed through the State Make Whole account, the role of the State Make Whole account and FIA/MiSDU Accounting greatly increased. The State Make Whole transactions currently include mail receipts, check disbursements, and bank account transfers.

FIA/MiSDU Accounting is staffed by one accountant, who reports to the Director of the Bureau of Accounting, and one other temporary staff person. FIA/MiSDU Accounting is located on site at ACS's facilities. The summarized transactions needed to record the financial activities of the SDU into MAIN were submitted to other Bureau of Accounting staff for review and approval. The detail transactions of the State Make Whole account were processed by the FIA/MISDU Accounting staff and were not submitted for review to any other Bureau of Accounting staff.

SCOPE

We performed an audit of the FIA/MiSDU Accounting's accounting for and processing of transactions of the State Make Whole Account (SMWA) for the period from October 1, 2000 through September 30, 2001. Our audit was conducted in accordance with Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

We obtained descriptions of, and documented the functions of, the FIA/MiSDU Accounting related to accounting for and processing of transactions of the State Make Whole Account. We gained an understanding of the accounting system used, evaluated the controls related to each function, and tested the transactions for compliance, where feasible. Our audit included the following:

- Monthly Bank Reconciliation.
- Mail Receipts.
- Check Issuance.
- Transfers between the SMWA and Other Bank Accounts.
- General Ledger Activity.

EXECUTIVE SUMMARY

Based on our review, we concluded that internal controls had been weakened by the addition of duties related to processing detail child support transactions to the FIA/MiSDU Accounting function. Some of the weaknesses in internal controls represented noncompliance with relevant FIA policies and procedures. The inadequate internal controls appeared to be a result of limited staff and increased requirements because of the child support processing needs that are not met by ACS. The FIA/MiSDU Accounting has made changes to the internal control structure that with a few additions should provide adequate controls over the current processing needs. However, because the FIA/MiSDU Accounting function includes both the actual processing of transactions and the oversight function, we conclude that the FIA/MISDU Accounting internal controls may not be adequate to provide reasonable assurance, as each need arises, that assets are safeguarded and all transactions are authorized and properly executed. Internal Controls have much less potential to be inadequate if the detail child support transaction processing was made a function of ACS and/or integrated into the statewide child support processing system.

FIA/MISDU ACCOUNTING'S RESPONSE

The FIA/MiSDU Accounting provided a list of current practices that they feel addressed the internal control weaknesses identified in each finding. (The current practice related to each finding is listed under the related finding.) FIA/MiSDU Accounting responded that our recommendation would be considered when they do the system design to expand the functionality of the SDU. They however believe that because they were able to address each finding the internal controls have not been permanently weakened.

COMMENTS RELATED TO THE RESPONSE

The separation of duties, oversight and logging that have been implemented for the most part appear to provide the necessary controls over current transactions. We, however, feel it is still necessary to have an independent person keep a record of the disposition of the checks received from the scan room. Also, someone who does not have access to the receipts accounting records should make the bank deposit. Also the Project Director should approve the ordering of all check stock and make sure it is delivered to the appropriate staff person.

FINDINGS AND RECOMMENDATIONS:

FIA/MiSDU Accounting should not process detail child support transactions. The detail child support transaction processing should be made a function of ACS and/or integrated into the statewide child support processing system.

FIA/MiSDU Accounting was intended to provide a review function over the ACS processing of child support receipts. Because ACS was not authorized to print checks, and there was a need to process certain transactions into and out of the State Make Whole account, FIA/MISDU Accounting was integrated into the actual daily processing of child support transactions. The State Make Whole account and FIA/MiSDU Accounting provided exceptions processing for certain child support transactions that ACS could not process. The addition of these daily processing transaction duties weakened the control that was intended to be provided by the oversight function of FIA/MiSDU Accounting because there is no longer a separation between the processing and the oversight functions.

These processing needs were not anticipated, and therefore, FIA/MiSDU Accounting developed practices and procedures as the needs occurred. We feel the unanticipated

needs, limited staff, and the choice to take on these processing duties led to the following inadequate controls that were discovered during the audit.

Check Disbursement Separation of Duties

1. The FIA/MiSDU Accounting did not properly separate the check disbursement duties. The accountant had access to the inventory of blank checks, had the ability to write checks, and sign the checks using a check signature machine. Proper internal control dictates that the person responsible for signing the checks should not have access to the blank checks or be involved in the disbursement function.

    The FIA/MiSDU Accounting has added additional staff. The Accounting Supervisor signs the checks but does not prepare the checks or maintain the check stock.

Check Signature Machine Reconciliation

2. FIA/MiSDU Accounting did not maintain a log of the checks signed by the check signature machine each day, and did not have a person that was independent of the disbursement function record the check signature machine meter reading each day. FIA/MiSDU Accounting also did not have an independent reconciliation of the meter reading record, signature log, and check register. The log, meter reading record, and the independent reconciliation help ensure that all signed checks are recorded in the accounting records.

    The Accounting Supervisor now does the reconciliation of the check signature machine. As noted under finding #1, the Accounting Supervisor does not prepare the checks and therefore is not involved in the disbursement function.

<u>Bank Reconciliation</u>

3. FIA/MiSDU Accounting did not have an independent person prepare the bank reconciliation. The accountant who prepared the bank reconciliation had access to blank checks, the ability to prepare checks, and to sign checks using a check signature machine. Proper internal controls dictate that the person who prepares the bank reconciliation must not write or sign checks, or have access to the inventory of blank checks. The accountant who prepared the bank reconciliation also had access to the mail receipts and the related accounting records.

    The Accounting Supervisor now prepares the bank reconciliation. As noted under finding #1, the Accounting Supervisor does not prepare the checks and therefore is not involved in the disbursement function. Also, the SDU Project Director, who does not do any of the accounting functions, gets the unopened bank statement including cancelled checks. The SDU Project Director reviews the cancelled checks, bank statement and the month-end bank reconciliation prepared by the Accounting Supervisor.

<u>Mail Receipts (including Returned Checks)</u>

4. FIA/MiSDU Accounting did not have two people work together to open the incoming mail and prepare a list of mail receipts and returned checks. Rather, the mail was opened individually by staff who had access to the receipt records. Proper internal control dictates that a record of the mail receipts be created at the time the mail is opened. Having two people (preferably who are independent of receipts function) open the mail helps to ensure that the mail record is complete and accurate. The purpose of the mail record is to help ensure that all mail receipts get deposited and recorded, and that returned checks are properly handled (e.g. voided).

Two staff persons now open the mail. One non-accounting staff person and an accounting staff person or two accounting staff open the mail. The accounting staff is involved in the receipt function. As the mail is opened the checks are listed on either a deposit slip or the checks received log.

Stop Payment Procedure

5.   FIA/MiSDU Accounting did not maintain an independent record of checks received from and returned to the ACS daily processing. Employer checks are removed from the daily ACS processing and turned over to the FIA/MiSDU Accounting. FIA/MISDU Accounting may return the check to ACS processing, return the check to the employer, or deposit the check into the State Make Whole account. Proper internal control dictates that someone independent of the receipt function creates a record of receipts. A person, involved in the receipt function, maintained the records for the FIA/MISDU Accounting and ACS did not maintain a record of the checks turned over to FIA/MISDU Accounting. ACS also did not maintain a record of the employer checks that were returned by FIA/MISDU Accounting to ACS daily processing. Therefore, an independent record needed to be maintained by FIA/MISDU Accounting. A person, who was not independent of the disbursement function, maintained the FIA/MISDU Accounting records. The independent records of checks received from, or returned to, ACS processing, help ensure that all checks were deposited, returned to the employer, or returned to ACS processing.

Currently, as the checks are received from the scanroom, an accounting staff person lists them on a stop payment log. The FIA/MiSDU Accounting feels that the ACS check logging function provides an independent record of checks

received from the scanroom. The Accounting Supervisor periodically reviews the stop payment log to ensure the disposition of each check logged.

Because the State Make Whole Account and FIA/MiSDU accounting are providing exception processing for ACS, all needs may not be anticipated. As pointed out above, the satisfaction of unanticipated needs can lead to inadequate controls. The separation of duties, oversight and logging that have been implemented appear to provide the necessary controls over current transactions. However, they may not provide the necessary controls over the next unanticipated need. Also, the detail processing of child support payments is done on two distinct systems. The weakest points in any accounting control systems are often the entry and exit points. The current arrangement creates multiple entry and exit points and therefore additional opportunities for breakdowns in controls.

WE RECOMMEND that FIA/MiSDU accounting detail transaction processing be absorbed into the ACS regular processing of child support and/or included in the statewide child support processing system (currently CSES).